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SUBJECT: KAZAKHSTAN CASPIAN TRANSPORTATION SYSTEM UPDATE

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: Representatives from the national oil companies of Azerbaijan and Kazakhstan met with international oil companies in Astana on February 10-11 to negotiate terms and conditions for the transportation of oil westward across the Caspian Sea. The director of oil transportation for KazMunaiGas was clearly frustrated by SOCAR's refusal to grant equity interest in the project to international oil companies, and by demands from those same companies for tax stability clauses that contradict current Kazakhstani law. END SUMMARY.

KMG AND SOCAR SET UP "KMG TRANS-CASPIY" JOINT VENTURE

13. (SBU) On February 17, Arman Darbayev, Executive Director for Oil Transportation and Service Projects at KazMunaiGas (KMG), told Energy Officer that KMG and the State Oil Company of the Azerbaijan Republic (SOCAR) met with Chevron (representing Tengizchevroil) and ExxonMobil (representing the Kashagan consortium) in Astana on February 10-11 to discuss implementation of the Kazakhstan Caspian Transportation System (KCTS). KCTS would transport Kazakhstani oil from the supergiant oil fields of Tengiz and Kashagan across the Caspian Sea to Baku and onward to world markets, without transiting Russian territory (reftel A). Darbayev said that on January 12, the new KMG-SOCAR joint venture, called "KMG Trans-Caspiy", appointed Mukhit Mazhenov as general director and Bolat Zakirov as deputy director. Both are Kazakhstanis. He also said that, although the parties were unable to reach agreement on project financing and equity structure, they did agree to begin the technical assessment necessary to sanction the 3-year, \$3 billion project.

BIONOTES FOR MAZHENOV AND ZAKIROV

14. (SBU) Mukhit Mazhenov was born on October 2, 1971, in Almaty, graduated with a degree in mathematics from Kazakhstan State University in 1992, and obtained a Master's degree from the Kazakhstan Institute of Management and Entrepreneurship in 1998. From 1998 to 2002, he headed the department of economic analysis at KazTransOil, the transportation arm of KMG; from 2002 to 2003, he directed the department for budget and planning at KMG; in 2003 he was advisor to the governor of Mangistau Oblast; from 2003 to 2004, he was director of the free trade zone "Aktau Sea Port"; from 2004 to 2005, he was deputy director general for development of TenizService, the oil services branch of KMG; from 2005 to 2007, he was deputy director for economics and finance at the Atyrau branch of Intergas Central Asia, which operates the Central Asia Center gas pipeline; from 2007 to 2008, he was first deputy chairman of the board of KazTransGas-Almaty, KMG's gas transportation and marketing company; and from February 2008 until his recent appointment as general director for KMG Trans-Caspiy, he served as deputy director general for economics and finance at KazTransOil.

15. (SBU) Bulat Zakirov was born on July 16, 1976, graduated from the Kazakhstan State Academy of Management in 1997, and obtained a Master's degree from the University of Dandy (UK) in 1998. From 1999 to 2006, he worked for KazTransOil in a variety of positions, including director of transport logistics in 2003; director of new business development in 2006; deputy director for corporate development from 2006 to 2009.

KMG AND SOCAR DISAGREE ON ROLE OF INTERNATIONAL COMPANIES

16. (SBU) Darbayev said that KMG is convinced that international oil companies (IOCs) should participate in the KCTS trans-Caspian project and is willing to offer them from 33 to 49 percent equity in the consortium. He cautioned, however, that the offer was

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contingent upon guaranteed volume commitments from the companies and the willingness of SOCAR to reduce its equity share in the venture. In other words, KMG would not agree to be the only partner to reduce its shareholding in order to attract IOCs to the project. "That would mean that SOCAR would own 50 percent of the new oil terminal at Kuryk -- on our territory. That, we cannot allow," Darbayev said. He added that KMG has "already compromised" with SOCAR on oil shipments from Baku onward. According to Darbayev, the two national oil companies reached a "gentlemen's agreement" to ship 50 percent of Kazakhstani crude from Baku to SOCAR's terminal at the Georgian port of Kulevi, and 50 percent to KMG's terminal at the Georgian port of Batumi.

17. (SBU) Darbayev said that during the negotiations in Astana this week, SOCAR could not understand why the IOCs representing Tengiz and Kashagan insisted on an equity stake in the new venture. He said SOCAR offered to guarantee tariff stability, crude quality, and pipeline access, if the IOCs would commit to a minimum supply of oil. The companies, however, insisted that equity will provide the same guarantees, plus greater managerial control over project development. Darbayev was concerned that SOCAR's unwillingness to trade equity for IOC finance and expertise will drive negotiations to a stalemate. "SOCAR thinks they can complete this project without the oil companies. We disagree," Darbayev said. "And they think the companies have nowhere else to turn. But if KCTS does not come together soon, the companies will export oil through pipelines to Russia or China."

KMG CONSIDERS DEMANDS FOR TAX STABILITY UNREASONABLE

18. (SBU) KMG's Darbayev was just as frustrated by demands from Chevron and ExxonMobil for guaranteed tax stability, noting that Kazakhstan's new Tax Code explicitly ends the principle of tax stability in contracts. "They want us to change the laws of the republic to accommodate them on this project. We simply cannot do that." Darbayev said KMG is willing to give the IOCs a significant equity stake in KCTS and favorable terms on tariffs, access, and quality, but KMG cannot adjust the country's entire investment climate just to please one or two partners. He said when Minister of Energy Sauat Mynbayev heard of the demand for tax stability, he

shook his head and said, "That is just too much to ask."

KMG WELCOMES USTDA FEASIBILITY STUDY

¶9. (SBU) Darbayev reiterated KMG's strong interest in a definitional mission by the U.S. Trade and Development Agency (USTDA) to assess the feasibility of KCTS and said that USTDA's "independent, expert assessment" would give the project a necessary seal of approval. Darbayev noted that, despite disagreements over ownership and the role of the IOCs, KMG and SOCAR remain committed to the project and have already begun to develop a scope of work for the requisite engineering studies. In fact, the next meeting of KMG Trans-Caspiy's board of directors is scheduled to take place in London on March 11, when the board will review the scope of work for the feasibility study.

KAZTRANSOIL EAGER TO JOIN KCTS

¶10. (SBU) On February 13, Energy Officer met Nurbol Sultan, the 32-year old, newly-appointed general director of KazTransOil (KTO), the oil transportation and marketing company wholly-owned by national oil company KazMunaiGas (KMG). Sultan, who has a degree in finance from Guildhall University in London, impresses one as a very pragmatic and rational business executive. He said he is focused on managing commercially successful projects in order to deliver a return on investment. "I don't worry about the politics of these projects. That's not my job," he said. He said KTO is eager to participate in KCTS and disclosed that they have already conducted a

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feasibility study on the pipeline portion of the project. Despite KTO's interest and expertise, however, Sultan said that KMG has not yet formally invited KTO to join the project. (NOTE: Sultan was unaware that SOCAR representatives were in Astana on February 10-11 to discuss financing and organizational issues for KCTS. END NOTE). Sultan said that he will travel on February 17 to Moscow to discuss expansion of the Atyrau-Samara pipeline with Transneft, and then to Azerbaijan and Georgia to discuss oil shipments from Baku to Batumi, where KTO owns and operates an oil terminal.

AMERICAN APPOINTED TO KAZTRANSOIL BOARD OF DIRECTORS

¶11. (SBU) On February 11, Energy Officer met Dan Mihalik, who was recently named to the board of directors of KTO. Mihalik said that KMG President Kairgeldy Kabyldin personally asked him to serve on the board, which is chaired by KMG First Vice President Maksat Idenov. According to Mihalik, KTO's immediate priority is to raise its accounting and health and safety practices to acceptable international standards. This would enable the company to raise capital for investments in new projects such as the Eskene-Kuryk pipeline that represents the first stage of KCTS. Mihalik said there are no insurmountable obstacles to KCTS, calling the remaining issues "purely technical and commercial." Mihalik will attend up to eight KTO board meetings per year and serve simultaneously as a senior technical consultant to Agip, one of the Kashagan consortium members.

¶12. (SBU) COMMENT: Although certain details remain to be worked out -- most notably whether or not international oil companies will take an equity stake in KCTS -- all major stakeholders agree that the project must move forward to accommodate increased crude production from Kashagan and Tengiz beginning in 2013. We believe that although the project is complex and the negotiations far from over, the parties involved understand that they have much to gain and little to lose from closing this deal. We urge colleagues in Baku and Washington to support the project in meetings with SOCAR and Azerbaijani government officials. Surprisingly, since KCTS provides an alternative oil export route that does not transit Russian territory, Russia has not openly opposed the project. That may be because Russia expects to win contracts for the construction of new oil tankers at the Astrakhan shipyard on the Volga River. END COMMENT.

HOAGLAND